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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 970

EDWARD J. BRUNENKANT, PETITIONER

v.

ANTHONY J. CELEBREZZE, SECRETARY OF HEALTH, EDUCATION AND WELFARE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The district court, in granting the Secretary's motion for summary judgment, wrote no opinion. The opinion of the court of appeals, affirming the district court's order, is reported at 310 F. 2d 355 (Pet. 16–23).

JURISDICTION

The judgment of the court of appeals was entered on October 31, 1962, and a petition for rehearing was denied on January 2, 1963. The petition for a writ of certiorari was filed on April 1, 1963. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether both courts below correctly held that there was substantial evidence in the administrative record to support the determination of the Secretary of Health, Education and Welfare that, during the period 1955 through 1957, petitioner received neither "self-employment income" nor "wages" within the meaning of Sections 211 and 209 of the Social Security Act.

STATUTE INVOLVED

The relevant provisions of the Social Security Act are, in pertinent part, the following:

Section 205(g), 53 Stat. 1368, as amended, 42 U.S.C. 405(g):

> * * * The findings of the Secretary as to any fact, if supported by substantial evidence, shall be conclusive * * *.

Section 209, 49 Stat. 625, as amended, 64 Stat. 492, 42 U.S.C. 409:

> For the purposes of this subchapter, the term "wages" means * * * remuneration paid after 1950 for employment, including the cash value of all remuneration paid in any medium other than cash * * *.

Section 211(a), 64 Stat. 502, as amended, 42 U.S.C. 411(a):

> (a) The term "net earnings from self-employment" means the gross income, as computed under chapter 1 of Title 26, derived by an individual from any trade or business carried on by such individual * * *; except that in computing such gross income * * *

* * * * *

(3) There shall be excluded any gain or loss (A) which is considered under chapter 1 of Title 26 as gain or loss from the sale or exchange of a capital asset * * *.

STATEMENT

In this action, commenced under Section 205(g) of the Social Security Act, 53 Stat. 1368, 42 U.S.C. 405(g), petitioner seeks to overturn the decision of the Secretary of Health, Education and Welfare that he was not entitled to social security benefits. The Secretary's decision was based on the finding that, during the period 1955 through 1957, petitioner had received neither "self-employment income" nor "wages" within the meaning of Sections 211 and 209, respectively, of the Social Security Act, *supra*, pp. 2–3, and thus lacked sufficient "quarters of coverage" [1] to qualify as "fully insured" [2] for old-age-insurance benefits.

Petitioner is licensed to practice law in Illinois and Ohio. In addition, he has been a member of the Chicago Board of Trade, a commodities exchange, since 1939. As such, he engaged in the buying and selling of commodity futures. During the period in question he acted as an odd-lot specialist [3] in wheat futures and as a speculator in futures of other com-

[1] As defined by Section 213(a), 64 Stat. 504, as amended, 42 U.S.C. 413(a).

[2] As defined by Section 214(a), 64 Stat. 505, as amended, 42 U.S.C. 414(a).

[3] In contrast to the usual futures trading in "round" lots (*i.e.*, 5,000-bushel lots), an odd-lot specialist trades in the more limited market for "job" or "odd" lots (*i.e.*, 1,000-bushel lots).

modities. Only his odd-lot activities are relevant here.

Prior to 1955, petitioner's odd-lot futures trading was conducted strictly in his own behalf; that is, he traded not as a broker but on his own account with his own funds. During this period he reported his earnings from such trading as capital gains for income tax purposes, but reported the same earnings for purposes of the Social Security Act as covered "self-employment income." Upon learning that earnings from futures trading, which are capital gains for income tax purposes, were within the express exclusion from coverage contained in Section 211(a)(3) of the Act, *supra*, pp. 2–3, petitioner ceased reporting such income, for Social Security Act purposes, as creditable earnings from self-employment.[4] Thereafter, during the period presently in controversy (1955 through 1957), petitioner continued to report his profits from odd-lot trading as capital gains for income tax purposes.

From 1955 through 1957, in addition to continuing odd-lot trading in his own behalf, petitioner pur-

[4] Petitioner's application for benefits claimed coverage for "self-employment income" from personal odd-lot futures trading during 1953 and 1954. The Bureau of Old-Age and Survivors Insurance of the Social Security Administration held itself barred by the Act's limitation period—contained in Section 205(c), 53 Stat. 1368, as amended, 42 U.S.C. 405(c)—from attacking the claimed 1953 earnings (and, thus, petitioner was accorded 4 quarters of coverage). As to the claimed 1954 earnings, however, the Bureau held them not covered. Petitioner did not attack this determination in the district court or the court of appeals, nor does he raise the question in the present petition.

ported to engage in identical trading in behalf of his family corporation, Commodity Investment Corporation. Although organized in 1953,[5] the corporation began functioning only in 1955, at the same time that petitioner ceased reporting the earnings from his odd-lot trading as "self-employment income" for Social Security Act purposes. The corporation's only activity was petitioner's odd-lot trading on its behalf, trading identical to that previously and concurrently engaged in by petitioner on his own account. The "primary asset" of the corporation was having petitioner on the Board of Trade, a membership that was personal and could not be transferred to the corporation, and corporate earnings were solely the product of this "asset."

During the years 1955 through 1957, petitioner was purportedly paid "wages" for his activity on behalf of the corporation. In 1955, the corporation purportedly earned $4,500, of which petitioner said he was paid $4,200 (the maximum annual wages then creditable under the Act); petitioner could produce no corroboration of this assertion, either in the form of cancelled checks or personal bank deposit state-

[5] The corporation was formed in Illinois by petitioner, his wife and their daughter in 1953, and was capitalized at $1,000. The three incorporators comprised the corporation's board of directors. In addition, petitioner was made its president and registered agent and petitioner's wife its secretary. Petitioner held a controlling interest in the outstanding stock of the corporation, and his wife and children held the balance. The corporation's address was that of petitioner's residence; it had no telephone listing, nor did its name appear on any corporate registry other than that published by the State of Illinois; at all times its bank account contained a nominal balance of from $200 to $400.

ments. In 1956, the corporation purportedly earned only $356.16, yet petitioner was allegedly paid $4,200. And in 1957 the corporation purportedly earned only $1,827.07, yet again petitioner was allegedly paid $4,200. In each of the last two years, "payment" was made in the form of promissory notes, signed by petitioner as president, which were not negotiable in form, and were never, in fact, paid.[6] In 1958, the year in which he reached retirement age and thus could have no more creditable earnings, the board of directors altered its compensation policy so as to pay salaries only in the event of profitable operation.

On the basis of the foregoing activity, petitioner filed an application for old-age insurance benefits.[7] While his application was based on other claims to coverage,[8] the two that remain in controversy both

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[6] After rejection of his claims by the Social Security Administration referee (now hearing examiner), and prior to review by the Appeals Council, the corporation's board of directors met and purported to redeem these notes by issuance of stock to petitioner. As noted below, note 14, *infra*, this transaction was ignored by the court below as completely lacking substance.

[7] Petitioner's wife also filed an application for wife's benefits. Her entitlement to such benefits is, of course, dependent upon petitioner's status. She joined neither the appeal to the court of appeals nor the present petition.

[8] Petitioner originally claimed "self-employment income" from futures trading during 1953 and 1954. See note 4, *supra*. In addition, petitioner claimed for the first time before the referee that the 1956–1957 portion of the claimed "wages" were "alternatively" creditable as "self-employment income" for legal services rendered to the corporation. Both the Secretary and the court of appeals rejected this so-called alternative claim as lacking evidentiary support and, in fact, inconsistent with petitioner's claim to "wages". (Pet. 22–23). Petitioner no longer contests this determination.

relate to the period 1955 through 1957: (1) that his earnings from odd-lot futures trading on his own account, although reported as capital gains for income tax purposes, qualify as "self-employment income" for Social Security Act purposes; and (2) that the salary he purportedly received from Commodity Investment Corporation constitutes creditable "wages" under the Act. The Secretary denied both claims.

With respect to petitioner's claim to coverage for earnings from personal odd-lot trading, the Secretary held that since commodity futures are universally regarded as capital assets, and since gains from the sale or exchange of capital assets are expressly excluded from Social Security coverage by Section 211(a)(3) of the Act, *supra*, pp. 2–3, petitioner had received no creditable "self-employment income" during the period in question. The Secretary expressly rejected petitioner's factual claim that his odd-lot trading was not speculative, because not dependent upon market fluctuations, and therefore constituted an exception to the above rule. On the basis of petitioner's own description of his practice, the Secretary found that while petitioner succeeded in partially reducing the risk of price fluctuations by matching a majority of his purchases or sales with corresponding sales or purchases at similar prices, the broad range of his trading remained fully subject to market fluctuations and was therefore speculative, albeit not to the fullest extent possible.

With respect to petitioner's claim that he received creditable "wages" from his family corporation, the

Secretary held that the corporate arrangement was to be disregarded as a mere sham or device employed by petitioner to circumvent the exclusion from Social Security Act coverage of earnings from futures trading (capital gains), and that, in any event, petitioner had failed to prove that the claimed salary had, in fact, been paid.

On review,[9] the district court granted the Secretary's motion for summary judgment without opinion. The court of appeals affirmed, holding that the Secretary's decision was fully supported by substantial evidence (Pet. 16–23). With respect to petitioner's claim to "self-employment income," the court confirmed the Secretary's finding that petitioner's trading was indeed speculative, and thus constituted no exception to the usual rule barring such earnings from coverage (Pet. 18–20). With respect to petitioner's claim to "wages," the court found substantial record support for the Secretary's findings (1) that the corporate arrangement was a mere device, lacking in substance, and utilized to convert non-creditable earnings into creditable "wages," and (2) that, in any event, the claimed salary had never been paid (Pet. 20–22).

ARGUMENT

Determination of the underlying issues turns essentially on the particular facts of petitioner's case. Since the overall question presented is thus a factual

[9] The Appeals Council originally declined to review the referee's determination. The district court, on its own motion, remanded the case for further hearing. The Appeals Council then took additional evidence and affirmed the referee's decision. The case was then again brought to the district court.

one, and since the Secretary's determination was clearly supported by substantial evidence, both courts below correctly held that determination binding. Therefore, there is plainly no occasion for further review.

1. Section 211(a)(3) of the Social Security Act, *supra*, pp. 2–3, expressly provides that capital gains are excluded from Social Security Act coverage. Commodity futures are universally regarded as capital assets,[10] even where the trading of such futures constitutes the taxpayer's full-time business,[11] and the profits from such trading constitute capital gains. *Faroll* v. *Jarecki*, 231 F. 2d 281 (C.A. 7), certiorari denied, 352 U.S. 830.

On the basis of the foregoing well-established principles, the Secretary determined that petitioner's earnings from odd-lot futures trading constituted capital gains, rejecting his claim that they did not qualify as such because they were not speculative. The court of appeals found this determination amply supported by the administrative record, observing (Pet. 19–20):

> The fact that [petitioner] chose contemporaneously to match most of his transactions (thereby taking only the risk of the daily short

[10] *E.g., Estate of Dorothy Makransky*, 5 T.C. 397, affirmed *per curiam*, 154 F. 2d 59 (C.A. 3); *Modesto Dry Yard, Inc.*, 14 T.C. 374; *Tennessee Egg Co.*, 47 B.T.A. 558.

[11] *Craig M. Smith*, 33 T.C. 465, 485. Thus, petitioner cannot import a third question into this case, one not decided by the court of appeals, by asserting (Pet. 13–14) that his odd-lot trading was his "trade" or "business," that his futures contracts were his "inventory" and that such inventory property is recognized as non-capital in nature.

> swings in the market), and run the risk of long-run price fluctuations on a small part of his trading merely reveals [petitioner's] conservative trading position. The limited degree of his speculation does not, for the purposes here concerned, either change the nature of his trading activities or qualify his profits therefrom as self-employment income rather than capital gains.

Petitioner has demonstrated no error in these conclusions.[12]

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[12] Petitioner asserts here, as he did in the court of appeals, that his matching practice constitutes "hedging" within this Court's decision in *Corn Products Refining Co.* v. *Commissioner*, 350 U.S. 46, and that his trading is thus excepted from the usual capital transaction characterization (Pet. 9–11). However, the *Corn Products* decision, and the cases which build upon it, demonstrate that the "hedging" exception to the capital transaction result inures only to the benefit of a producer, manufacturer or processor of a commodity who trades in the futures of that commodity in order to control its cost-of-goods-sold by stabilizing the cost of its inventory, and that one who merely trades in futures cannot "hedge" in this special sense of the term. See, *e.g.*, *Farrell* v. *Jarecki*, *supra*, 231 F. 2d 281 (C.A. 7), certiorari denied, 352 U.S. 830; *Flora* v. *United States*, 142 F. Supp. 602, 605–606 (D. Wyo.), dismissed on other grounds, 246 F. 2d 929 (C.A. 10), affirmed, 357 U.S. 63, 362 U.S. 145; *Steanoff Vegetable Oil Corp.*, 27 T.C. 1056, 1067–1068, reversed on other grounds, 251 F. 2d 764 (C.A. 7). In view of these requirements the court of appeals properly rejected petitioner's assertions that his odd-lot trading constituted hedging (Pet. 19): "[Petitioner's] reliance upon *Corn Products* is misplaced. [He] was not a manufacturer, processor or handler of the actual commodity but merely a trader in futures of the commodity who did not contemplate taking possession of the 'actuals.'" Petitioner's assertion that this holding is in conflict with the *Corn Products* rule is plainly without merit.

2. With respect to petitioner's claim to "wages" based upon the putative employment by his family corporation, the Secretary held that the corporation could be disregarded as a mere sham or device employed to circumvent the exclusion from coverage of petitioner's earnings from futures trading on his own account, and that, in any event, the claim to "wages" must be rejected since petitioner failed to prove the actual receipt of the alleged salary. The court of appeals sustained this determination as supported by substantial evidence (Pet. 20-22).

The petition does not attack the substantiality of the evidence supporting the finding that petitioner's family corporation was a sham for Social Security Act purposes. Rather, petitioner relies on the assertion that such an inquiry is beyond the power of the Secretary and urges that the decision below conflicts with *Stark* v. *Flemming*, 283 F. 2d 410 (C.A. 9).

There is no conflict with the *Stark* case,[11] but even if there were, this case would be an inappropriate

[11] In *Stark*, the Ninth Circuit held that where there has been "proper adherence to the normal corporate routines * * * it is difficult to understand how the corporate arrangement would not have to be respected by others than the Secretary. And we think he must respect it, too" (283 F. 2d at 410). This holding plainly implies that the Secretary can inquire whether, following incorporation, the business was conducted in conformity with "the normal corporate routines," and upon finding that it has not, disregard it as a separate legal entity for Social Security Act purposes, which is, of course, precisely what he did here.

Petitioner also alleges conflict in another Ninth Circuit case, *Flemming* v. *Lindgren*, 275 F. 2d 596. But if *Lindgren* has any bearing upon this question it demonstrates that there is no

one for its resolution. For no matter what might be concluded with respect to the Secretary's power to "pierce the corporate veil" for purposes of determining the true nature of petitioner's so-called "wages" for Social Security Act purposes, the Secretary found that petitioner had not actually received the putative salary from the corporation. With respect to the alleged 1955 cash salary, the record contains only petitioner's uncorroborated assertion. And with respect to 1956 and 1957, plaintiff received promissory notes, which the Secretary observed were non-negotiable and, in fact, unpaid.[11] In such circumstances the court of appeals had little difficulty in concluding that the Secretary's finding was fully supported by the administrative record and thus binding (Pet. 22). Petitioner has not demonstrated even arguable error in this finding.

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conflict here, for there the Ninth Circuit stated that the Secretary "must be permitted to look through form to substance," and where a "rather shallow corporate device" is employed, he is "entitled to take not one, but several long looks at it" (275 F. 2d at 597).

[11] As noted above, note 6, *supra*, an attempt was made, in the interim between the referee's and Appeals Council's decisions, to give substance to these notes by issuance of corporate stock in purported redemption. The Secretary, noting its timing, held that this transaction was without substance, since the issued stock was itself worthless. The court of appeals, in affirming this finding, held that "in light of the evidence concerning the corporation's financial structure and net operating losses," the stock "would appear to be worthless" (Pet. 22).

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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